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No. 58

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

v.

S. C. THOMSON

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT.

T. F. DAVIES HAINES,
Attorney for Respondent.

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BRIEF FOR RESPONDENT

Opinions Below

The opinion of the United States Board of Tax Appeals (R. 6-9) is reported in 40 B. T. A. 60. The opinion of the Circuit Court of Appeals (R. 40-41) is reported in 108 F. (2d) 642.

Jurisdiction

The judgment of the Circuit Court of Appeals was entered January 25, 1940 (R. 41-42). The petition for a writ of certiorari was filed April 25, 1940, and was granted May 20, 1940 (R. 42). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Statement of the Case

In his income tax return for 1934 the respondent claimed a deduction of $24,625 for a bad debt under Section 23(k) of the Revenue Act of 1934 (R. 7). The Commissioner disallowed the deduction on the ground that the transaction should be considered an exchange under Section 117(f) of the Revenue Act of 1934 and determined a deficiency in the tax (R. 4). The Board of Tax Appeals sustained the Commissioner (R. 5-9). The Circuit Court of Appeals unanimously reversed the Board and held that the transaction was not an exchange under Section 117(f) but a bad debt under Section 23(k) (R. 39-42).

The respondent purchased in May, 1927, $25,000 face amount of New York United Hotels, Inc. debentures maturing February 1, 1947 at a cost of $24,750 (R. 13). The debtor was a corporation organized to lease and operate the Roosevelt Hotel in New York City (R. 16). Its assets consisted of the lease and the furnishings and equipment of the hotel (R. 18).

On December 15, 1933 receivers were appointed for the debtor corporation by the United States District Court for the Southern District of New York (R. 13).

A plan of reorganization was submitted to the court under which a new corporation was to be formed to purchase all the assets of the debtor and either negotiate a new lease with the lessor or obtain an assignment of the existing lease with modifications (R. 15-24). The new corporation was to issue debentures, preferred and common stock; and substantially all of the new debentures ($1,205,000) were to go to the lessor in satisfaction of the debtor's indebtedness to it under the lease (R. 24).

The holders of the old debentures were given a choice of (1) acquiring common stock of the new company in exchange for old debentures in the ratio of 2½ shares of stock for each $1,000 debenture (R. 23), or (2) acquiring new debentures and preferred and common stock of the new company in

exchange for the old debentures plus a cash payment equal to the par value of the new debentures so acquired (R. 23).

General creditors of the debtor corporation were offered 2½ shares of common stock of the new company for each $1,000 of indebtedness (R. 22). Thus the old debenture holders who did not wish to put fresh money into the new company were treated in the same fashion as general creditors.

This plan was approved by the District Court (R. 27-32), but by final order of May 22, 1934 (R. 33-36) the court directed that debenture holders and other creditors of the debtor not participating in the plan should be paid out of the cash balance in the hands of the Receivers the sum of $5.00 per each $1,000 face value of debentures or creditors' claims, such payment to be made upon surrender of the debentures or assignment of the claims within 90 days of the order (R. 36). To carry out the terms of its order affecting the non-participating debenture holders and creditors, the court ordered that the receivers turn over the balance of cash and accounts receivable in their hands to the lessor of the debtor on condition that the lessor pay therefrom to the new company the amount necessary to enable the new company to pay certain past due franchise taxes and the non-participating debenture holders and other creditors (R. 35-36). In this way the receivers were discharged upon the transfer of the receivership balances to the lessor.

The respondent refused to participate in the reorganization plan, surrendered his debentures on June 22, 1934 and received a payment of $125 (R. 14) representing a dividend of ½ of 1¢ on the dollar. This payment corresponded to the liquidating dividend paid to other non-participating creditors of the debtor.

The plan of reorganization was objected to by certain of the debenture holders, who appealed from the final order to the Circuit Court of Appeals for the Second Circuit. The Circuit Court affirmed the District Court in *Rockwell* v. *New York United Hotels*, 79 F. (2d) 81, certiorari denied, *sub nom, Donahue* v. *Rockwell*, 296 U. S. 650.

The question on this appeal is whether the payment to the respondent of the liquidating dividend of $125 on his debentures having a face value of $25,000 and for which he had paid $24,750 resulted in a bad debt deductible under Section 23(k) of the Revenue Act of 1934, or whether the payment can fairly and properly be said to constitute a "retirement" of the debentures within the meaning of Section 117(f).

Summary of Argument

I. The respondent's loss on his debentures constituted a bad debt within the meaning of Section 23(k) of the Revenue Act of 1934. The debentures constituted a "debt" within the meaning of Section 23(k). The payment of the first and final dividend on the debentures of $5 per $1,000 in the receivership proceedings proved their worthlessness.

Section 23(k) of the Act and the corresponding Regulation, Article 23(k) of Regulations 86, specifically cover the respondent's loss without in any way straining the language contained therein. Section 117(f) of the Act which covers the "retirement" of bonds could only be made to apply by giving a strained and unusual meaning to the word "retirement".

II. Section 117(f) of the Revenue Act of 1934 relating to the "retirement of bonds" has no application to the respondent's loss. "Retirement" as used in Section 117(f) must be given its common and ordinary meaning, which is a "payment" of "withdrawal from circulation" of the debtor's obligations by some voluntary act of the debtor. It does not mean an involuntary extinguishment of the obligations by the payment of a nominal dividend in insolvency proceedings.

The fact that Section 117(f) uses the word "retirement" rather than the word "redemption" does not indicate that Congress intended "retirement" to cover an extinguishment

of an obligation in insolvency proceedings. "Retirement" may have a broader meaning than "redemption", but both words imply that the debtor effecting the "redemption" or "retirement" be a free agent or acting entity.

There is no indication that Congress intended to classify a loss like the respondent's as a capital loss rather than as a bad debt. Had Congress had such an intention it would have accomplished it by an amendment to Section 23(k), which Congress in fact did in the Revenue Act of 1938.

ARGUMENT

I

The payment of the first and final liquidating dividend of one-half of one per cent on the debentures made them a debt worthless in part, the uncollectible portion of which was deductible as a bad debt under Section 23(k) of the Revenue Act of 1934.

The Revenue Act of 1934 made a clear distinction between two different types of losses sustained by taxpayers on bonds and similar securities. The first type of loss was that resulting from debts "ascertained to be worthless" or "recoverable only in part", was covered by Section 23(k) of the Act* and could be entirely deducted from gross income. The second type of loss was that resulting from "the sale or exchange of a capital asset", was covered by Section 117 of the Act and could be deducted only to the extent of $2,000 plus the gains from such sales or exchanges. Section 117(f) provided in effect that losses resulting from a retirement of bonds, practically speaking a purchase of the bonds by the debtor, should be treated in the same way as a loss resulting from a sale to a third party.

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* The pertinent provisions of all statutes and regulations involved will be found in the Appendix, *infra*, pp. 14-18.

The respondent's loss in the instant case was a loss of the first type expressly covered by Section 23(k) of the Act.

The respondent's debentures were clearly evidences of debt. The Treasury Department treated "bonds of an insolvent corporation" as bad debts deductible under Section 23(k) (Article 23(k)-4 of Regulations 86, Appendix, *infra*, p. 18). And the Government concedes, as it must, that bonds have been treated as debts within the meaning of the bad debt provisions of the Revenue Act of 1934 and previous statutes (Brief, p. 27).

It is equally clear that the first and only dividend received by the respondent on the debentures in the insolvency proceedings, amounting to one-half of one per cent of his investment and paid out of the available funds left in the hands of the receivers, demonstrated their partial worthlessness. Article 23(k)-2 specifically mentions as an example of a bad debt "the difference between the amount received in distribution of the assets of a bankrupt and the amount of the claim".

Consequently the Circuit of Appeals correctly held that "the case was one of bad debt" (R. 41).

The Government's argument that the respondent's loss is covered, not by Section 23(k) of the Act, but rather by Section 117(f), is contained in subsection 5 of its brief, at pages 26-30. The substance of the argument is that Section 117(f) "deals specifically with the retirement of bonds", that it is a "well-established rule of construction that a specific provision prevails over a general provision", so that "Section 117(f) controls if there was a retirement of the bonds, even though Section 23(k) might otherwise be applicable" (Brief, p. 29). In other words, the Government admits that Section 23(k) covers the loss here involved, but maintains that Section 117(f) covers it more specifically.

The answer is that Section 23(k) and the corresponding article of the Regulations apply exactly to the respondent's loss without in any way straining the language therein contained. But in order to make Section 117(f) apply, a distorted and unusual meaning must be given to the language therein used.

Section 23(k) covers "debts ascertained to be worthless" and "recoverable only in part". A debt extinguished by the payment of a small dividend in a receivership proceeding is just such a debt.

Article 23(k)-1 of the Regulations provides that "bankruptcy is generally an indication of the worthlessness of at least a part of an unsecured and unpreferred debt". The Government's statement (Brief, p. 27) that "the above regulation appears to be applicable only to unsecured and unpreferred debts" is concededly correct. But that fact does not make the provision inapplicable to this case, for the respondent's debentures were "unsecured and unpreferred" debts of New York United Hotels, Inc. (See *Rockwell* v. *New York United Hotels*, 79 F. (2d) 81, *supra*).

Article 23(k)-2, which the Government's brief does not mention, specifically gives as an example of a bad debt coming within the provisions of Section 23(k) "the difference between the amount received in distribution of the assets of a bankrupt and the amount of the claim."

Article 23(k)-3 covers the "uncollectible deficiency upon sale of mortgaged or pledged property". As the respondent's debentures were unsecured this article has no application.

Article 23(k)-4 states that "bonds, if ascertained to be worthless, may be treated as bad debts to the amount actually paid for them". This article thus exactly covers the case at bar. The Government's only comment is (1) that the article "may relate only to bonds which do not constitute capital assets as defined in Section 117" and (2) that "probably it was intended to govern obligations not otherwise removed from the operation of the bad-debt

provisions by such specific provisions relating to capital losses as are contained in Section 117" (Brief, p. 28). The first comment is without support in either the statute or the Regulations, for nothing in either suggests that losses sustained by virtue of capital assets becoming worthless may not be deducted as bad debts, and the contrary is of course the case (*Commonwealth Commercial State Bank* v. *Lucas*, 41 F. (2d) 111 (C. A. D. C.); *Pacific National Bank of Seattle* v. *Commissioner*, 91 F. (2d) 103 (C. C. A. 9); *Huntting* v. *Commissioner*, 32 B. T. A. 495; *Corbett* v. *Commissioner*, 15 B. T. A. 698). The second comment would only be material if the respondent's loss were covered by Section 117.

The provisions of Section 117, however, only apply if the extinguishment of the obligation represented by the debentures in the receivership proceedings constituted a "retirement" of the bonds under Section 117(f). Section 117 would not apply if the transaction did not constitute a "retirement" but merely rendered the obligation totally or partially worthless (Regulations 86, Art. 117-4, Appendix, *infra*, p. 18). In the following point it is shown that only by giving the word "retirement" the most distorted and unusual meaning can it be made to apply to the transaction involved in this case.

II

Section 117(f) of the Revenue Act of 1934 relating to the "retirement of bonds" has no application to the respondent's loss.

The Government concedes (Brief, p. 11) that in the absence of Section 117(f) of the Revenue Act of 1934 this transaction would not be a sale or exchange within the meaning of Section 117(d). Section 117(f) provides as follows:

> "(f) *Retirement of bonds, etc.*—For the purposes of this title, amounts received by the holder upon the

> retirement of bonds, debentures, notes or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subsidiary thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor."

The question is, therefore, whether or not the payment by the receivers of the debtor corporation of one-half of one per cent on the respondent's debentures constituted a "retirement" of the debentures within the meaning of the statute.

The Government points out (Brief, p. 12) that, as the word "retirement" has no established legal meaning, it must, under the rules of construction consistently followed by this Court, be given its common and ordinary meaning. The Government then quotes (Brief, p. 13) two dictionary definitions of "retire": the first, that it means "to withdraw from circulation, or from the market; to take up or pay"; the second, that it means "to recover; redeem; regain by the payment of a sum of money". Clearly these words mean "withdraw from circulation", "take up", "pay" or "recover" by some voluntary act of the debtor. They do not cover the involuntary extinguishment of the debtor's obligation by the payment of a nominal dividend in insolvency proceedings.

The distinction is well brought out in the opinion of the Circuit Court of Appeals, in which the Court stated (R. 41):

> "Dictionary definitions of 'retire' are 'to pay up and withdraw from circulation', 'to withdraw from circulation or from the market', 'to take up or pay'. The word signifies some voluntary action on the debtor's part in fulfillment of his promise to pay. A man as sanguine as Micawber might describe his bankruptcy as a 'retirement' of his obligations, but a merchant seeking credit who spoke in such euphemisms might find himself in trouble later. Where creditors receive a petty dividend (one-half of one per cent in this case) on the collapse of their debtor, their claims may be extinguished but are hardly 'retired'."

The true meaning of "retirement" is also made plain in *Empire Security Co.* v. *Berry*, 211 Ill. App. 278, cited by the Government (Brief, p. 13) as approving one of the dictionary definitions of "retire". In that case the plaintiff was the holder of a promissory note and of a guaranty by a third party that the note would be "retired". The maker of the note defaulted and the plaintiff sued the guarantor. The court held that "retirement" meant "payment" and held for the plaintiff.

The citation by the Government of the *Berry* case shows the fallacy in its argument. If respondent in the instant case had held the guaranty of a third party to pay the debentures if they were not "retired", the Government could hardly argue that the guarantor's obligation would have been extinguished by the payment of one-half of one per cent on the debentures in the receivership proceedings.

The Government states (Brief, p. 13) that "as employed in its ordinary sense, the word 'retirement' is properly used to describe the transaction by which, in receivership or bankruptcy proceedings, the bondholders or debenture holders of a debtor corporation are required to surrender their bonds or debentures and accept cash payments in full satisfaction of their debt so that a reorganization may proceed". Even if the word "retirement" could be stretched to apply to a transaction such as that described by the Government, it would have no application to the present case. The respondent was not, as the Government suggests, "required to surrender" his debentures and accept a cash payment in satisfaction of his claim so that the reorganization could proceed. The respondent had nothing to do with the reorganization, but was simply one of a number of general creditors who refused to participate in the reorganization and who was therefore paid a dividend of one-half of one per cent out of the receivership assets. If he had chosen not to surrender

his debentures against the nominal liquidating dividend the reorganization would nevertheless have proceeded to a final conclusion, for the court order so provided (R. 35-36). And the same payment would necessarily have been made even if no reorganization had been contemplated.

There were open to the respondent the following three alternative courses:

(a) To participate in the plan by surrendering his debentures to the new company (with or without a cash payment) in exchange for securities of the new company;

(b) To proceed under the court's final order by surrendering his debentures within 90 days in exchange for a first and final liquidation payment of $5 per $1,000 debenture out of the cash balance in the hands of the receivers;

(c) To disregard both the plan and the order and to allow the debentures to become wholly worthless and a complete loss at the expiration of 90 days.

The respondent chose the second of these three alternatives. But suppose that he had chosen the third alternative. Would the Government have argued that his worthless debentures represented anything but a 100% loss on a bad debt? And if not, what difference can it make that the respondent took the trouble to salvage at least one-half of one cent on the dollar in the form of a sole and final liquidation dividend out of the meager funds left in the hands of the receivers?

The Government's discussion (Brief, pp. 14-16) of the relative meanings of "redemption" and "retirement" is beside the point. Of course, "retirement" includes and is broader than "redemption", but both words have the prefix "re" meaning "back" and consequently both words apply only to a "withdrawal from circulation" when made by the debtor itself. If the debtor pays off and retires its

bonds in accordance with their terms, the transaction is admittedly a "redemption" and the bonds may be said to have been both "redeemed" and "retired". If the debtor solicits and obtains tenders of its bonds from the bondholders at some price less than the redemption price, the transaction can be fairly termed a "retirement" of the bonds, but not a "redemption". To that extent "retirement" is broader than redemption. But in the use of both terms it is implicit that the debtor effecting the "redemption" or "retirement" be still a free agent or acting entity and that he continue so after the bonds have been redeemed or retired.

In view of the clear and unambignous language of the statute, there is no relevancy in the Government's discussion (Brief, pp. 19-26) of the legislative history as disclosing the intention of the Congress in enacting Section 117(f) of the Revenue Act of 1934 (*Standard Fashion Co.* v. *Magrane-Houston Co.*, 258 U. S. 346, 356). Let it be granted that the legislative intent was to classify as a capital gain or loss any gain or loss resulting from a "retirement" of corporate obligations. What happened in the case at bar cannot possibly be considered a "retirement" in any grammatical or legal sense for the reasons already given, at least unless the wording of Section 117(f) discloses an intent to extend the meaning of "retirement" so far beyond its normal limits as to include a surrender of corporate bonds against payment of a final liquidating dividend out of receivers' funds. But nothing in either the wording or context of Section 117(f) suggests such an intent. On the contrary, Regulations 86 under the Revenue Act of 1934 (approved by the Secretary of the Treasury on February 11, 1935), provide as follows at Article 117-4:

> "*Application of Section 117 generally*—Section 117 applies only to gains and losses upon the sale or exchange of capital assets and, therefore, has no application to loss of useful value upon the

permanent abandonment of the use of property (see Article 23 [e]-3) or loss sustained as a result of corporate stock or debts becoming worthless."

Had it been intended to classify a loss like respondent's as a capital loss rather than a bad debt the Congress would have found no difficulty in saying so in plain language, and by amendment to Section 23(k) which deals with bad debts. In fact, the Congress did exactly that in 1938 (Revenue Act of 1938, Section 23(k), Appendix, *infra*, p. 15).

There is no mystery about the purpose of Section 117(f). The Courts had previously held that a *redemption* of bonds *before maturity* by the *issuing corporation* could not be treated as a sale or exchange of capital assets within the commonly accepted meaning of the words. *Fairbanks* v. *U. S.*, 95 F. (2) 794, aff'd 306 U. S. 436; *Watson* v. *Commissioner*, 27 B. T. A. 463. So the Congress enacted Section 117(f) to nullify the effect of these decisions and to classify any kind of voluntary retirement by the issuing corporation before maturity as a sale or exchange of capital assets. But in making this change in Section 117 the Congress had no intention of amending the provisions of Section 23(k) which applied to bonds ascertained to be worthless as the result of the insolvency of the issuing corporation.

CONCLUSION

The decision of the Circuit Court of Appeals should be affirmed.

Respectfully submitted,

T. F. DAVIES HAINES,
Attorney for Respondent.

APPENDIX

Revenue Act of 1934, May 10, 1934, c. 277, 48 Stat. 680:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * * *

(k) *Bad debts.*—Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction.

* * * * * * *

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 1 year;

80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

40 per centum if the capital asset has been held for more than 5 years but not for more than 10 years;

30 per centum if the capital asset has been held for more than 10 years.

(b) *Definition of capital assets.*—For the purposes of this title, "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

* * * * * * *

(d) *Limitation on capital losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. If a bank or trust company incorporated under the laws of the United States or of any State or Territory, a substantial part of whose business is the receipt of deposits, sells any bond, debenture, note, or certificate or other evidence of indebtedness issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, any loss resulting from such sale (except such portion of the loss as does not exceed the amount, if any, by which the adjusted basis of such instrument exceeds the par or face value thereof) shall not be subject to the foregoing limitation and shall not be included in determining the applicability of such limitation to other losses.

* * * * * * *

(f) *Retirement of bonds, etc.*—For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor.

* * * * * * *

Revenue Act of 1938, May 28, 1938, c. 289, 52 Stat. 447:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * * *

(k) *Bad debts.*—

(1) GENERAL RULE.—Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction. This paragraph shall not apply in

the case of a taxpayer, other than a bank, as defined in section 104, with respect to a debt evidenced by a security as defined in paragraph (3) of this subsection.

(2) SECURITIES BECOMING WORTHLESS.—If any securities (as defined in paragraph (3) of this subsection) are ascertained to be worthless and charged off within the taxable year and are capital assets, the loss resulting therefrom shall, in the case of a taxpayer other than a bank, as defined in section 104, for the purposes of this title, be considered as a loss from the sale or exchange, on the last day of such taxable year, of capital assets.

(3) DEFINITION OF SECURITIES.—As used in this subsection the term "securities" means bonds, debentures, notes, or certificates, or other evidences of indebtedness, issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form.

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 23(k)-1. *Bad debts.*—

* * * * * *

Where the surrounding circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, a showing of these facts will be sufficient evidence of the worthlessness of the debt for the purpose of deduction. Bankruptcy is generally an indication of the worthlessness of at least a part of an unsecured and unpreferred debt. Actual determination of worthlessness in bankruptcy cases is sometimes possible before and at other times only when a settlement in bankruptcy shall have been had. Where a taxpayer ascertained a debt to be worthless and charged it off in one year, the mere fact that bankruptcy proceedings instituted against the debtor are terminated in a later year, confirming the conclusion that the debt is worthless, will not authorize shifting the deduction to such later year. If a taxpayer com-

putes his income upon the basis of valuing his notes or accounts receivable at their fair market value when received, which may be less than their face value, the amount deductible for bad debts in any case is limited to such original valuation.

* * * * * *

ART. 23(k)-2. *Examples of bad debts.*—Worthless debts arising from unpaid wages, salaries, rents, and similar items of taxable income will not be allowed as a deduction unless the income such items represent has been included in the return of income for the year for which the deduction as a bad debt is sought to be made or for a previous year. Only the difference between the amount received in distribution of the assets of a bankrupt and the amount of the claim may be deducted as a bad debt. The difference between the amount received by a creditor of a decedent in distribution of the assets of the decedent's estate and the amount of his claim may be considered a worthless debt. A purchaser of accounts receivable which can not be collected and are consequently charged off the books as bad debts is entitled to deduct them, the amount of deduction to be based upon the price he paid for them and not upon their face value.

ART. 23(k)-3. *Uncollectible deficiency upon sale of mortgaged or pledged property.*—If mortgaged or pledged property is lawfully sold (whether to the creditor or another purchaser) for less than the amount of the debt, and the mortgagee or pledgee ascertains that the portion of the indebtedness remaining unsatisfied after such sale is wholly or partially uncollectible, and charges it off, he may deduct such amount (to the extent that it constitutes capital or represents an item the income from which has been returned by him) as a bad debt for the taxable year in which it is ascertained to be wholly or partially worthless and charged off. In addition, if the creditor buys in the mortgaged or pledged property, loss or gain realized measured by the difference between the amount of those obligations of the debtor which are applied to the purchase or bid price of the property (to the extent that such obligations constitute capital or represent an item the income from which

has been returned by him) and the fair market value of the property. The fair market value of the property shall be presumed to be the amount for which it is bid in by the taxpayer in the absence of clear and convincing proof to the contrary. If the creditor subsequently sells the property so acquired, the basis for determining gain or loss is the fair market value of the property at the date of acquisition.

Accrued interest may be included as part of the deduction only if it has previously been returned as income.

ART. 23(k)-4. *Worthless bonds and similar obligations.*—Bonds, if ascertained to be worthless, may be treated as bad debts to the amount actually paid for them. Bonds of an insolvent corporation secured only by a mortgage from which on foreclosure nothing is realized for the bondholders are regarded as ascertained to be worthless not later than the year of the foreclosure sale, and no deduction for a bad debt is allowable in computing a bondholder's income for a subsequent year.

A taxpayer (other than a dealer in securities) possessing debts evidenced by bonds or other similar obligations can not deduct from gross income any amount merely on account of market fluctuation. If a taxpayer ascertains, however, that due, for instance, to the financial condition of the debtor, or conditions other than market fluctuation, he will recover upon maturity none or only a part of the debt evidenced by the bonds or other similar obligations and so demonstrates to the satisfaction of the Commissioner, he may deduct in computing net income the uncollectible part of the debt evidenced by the bonds or other similar obligations.

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ART. 117-4. *Application of section 117 generally.*—Section 117 applies only to gains and losses upon the sale or exchange of capital assets and, therefore, has no application to loss of useful value upon the permanent abandonment of the use of property (see article 23(e)-3), or loss sustained as the result of corporate stock or debts becoming worthless.

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SUPREME COURT OF THE UNITED STATES.

Nos. 55, 58.—October Term, 1940.

Donald S. McClain, Petitioner, vs. Commissioner of Internal Revenue.	On Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.
Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, vs. Florence Stanton Thomson, Executrix Under the Will of S. C. Thomson, Deceased.	On Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

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58

[January 6, 1941.]

Mr. Justice Roberts delivered the opinion of the Court.

These cases present the question whether upon the surrender of bonds or debentures in exchange for a money payment less than cost, a taxpayer may deduct the loss from his gross income as a bad debt under § 23(k)[1] or must treat it as a capital loss under § 117(f)[2] of the Revenue Act of 1934.

In number 55 it appears that the taxpayer owned $15,000 par value of bonds of a water district, acquired by gift. The district being in financial difficulties offered to pay $7,476.75 for them. The offer was accepted and the bonds delivered. In his tax return the taxpayer claimed a deduction of $7,523.25 as for a bad debt charged off. The Commissioner disallowed the deduction, and the Board of Tax Appeals and the Circuit Court of Appeals[3] sustained his ruling.

In number 58 the facts are that the taxpayer bought $25,000 par value of debentures for $24,750. The issuer's affairs were placed in the hands of a receiver. A plan of reorganization provided that

[1] 48 Stat. 689; 26 U. S. C. § 23(k).
[2] 48 Stat. 715; 26 U. S. C. § 117(f)
[3] 110 F. (2d) 878.

the receiver should pay $5.00 for each $1000 debenture surrendered for cancellation. The taxpayer availed himself of this provision, and in his tax return claimed a deduction of $24,625, as for a bad debt. The Commissioner disallowed the claim, and the Board of Tax Appeals affirmed his decision. The Circuit Court of Appeals reversed.[4]

By reason of the conflict of decision we granted certiorari in both cases.

The earlier revenue acts contained sections similar to 23(k) of the Act of 1934. They also embodied provisions for calculation of taxes on capital net gains. None of them included any section like 117(f). Prior to the adoption of the 1934 Act it had been held that the phrase "sale or exchange" of capital assets, employed in those Acts, was not descriptive of the redemption or call for repayment of corporate securities, and hence gain thereby occasioned was to be treated as ordinary income[5], and loss so arising was to be deducted from gross income as a bad debt.[6]

The Revenue Act of 1934, by sub-section (f) of § 117, provided that for the purposes of the title dealing with capital gains and losses, "amounts received by the holder upon the retirement" of such securities as are here involved, "shall be considered as amounts received in exchange therefor".

It is plain that Congress intended by the new sub-section (f) to take out of the bad debt provision certain transactions and to place them in the category of capital gains and losses. The question is whether by employing the word "retirement" the transactions here involved were so transferred. We hold that they were.

"Retirement" aptly describes what occurred in the instant cases. The statute does not use the word in an unusual or artificial sense. In common understanding and according to dictionary definition the word "retirement" is broader in scope than "redemption"; is not, as contended, synonymous with the latter, but includes it. Nothing in the legislative history of the provision requires us to

[4] 108 F. (2d) 642.

[5] Watson *v.* Commissioner, 27 B. T. A. 463; Braun *v.* Commissioner, 29 B. T. A. 1161. This view was adopted by this court as respects the Revenue Act of 1928, subsequent to the adoption of the Act of 1934. Fairbanks *v.* United States, 306 U. S. 436.

[6] Commonwealth Bank *v.* Lucas, 41 F. (2d) 111; Lebanon Nat. Bank *v.* Commissioner, 76 F. (2d) 792; Pacific Nat. Bank *v.* Commissioner, 91 F. (2d) 103.